

# PENSIONS ASPECTS OF THE BUDGET

## TAX RELIEF ON PENSION CONTRIBUTIONS REMAINS - FOR NOW

The National Recovery Plan threatened to reduce income tax relief on pension contributions to 20%, regardless of the individual's marginal rate of tax. The Minister did not bring in this change in the Budget, pending discussions with private pension stakeholders around an alternative method of making a €500 million saving. Individuals paying income tax at the higher rate of 41% will continue to receive full tax relief on their contributions until further notice.

## PRSI RELIEF WITHDRAWN FROM EMPLOYEE CONTRIBUTIONS

However as expected, employee contributions will no longer get PRSI relief, and they will also be subject to the Universal Social Charge which replaces the health and income levies (see page 4). In addition, employers' PRSI relief on employee contributions will be reduced by 50%. This means that for every €100 pension contribution made by an employee, the employer will have to pay PRSI of €5.38.

## REDUCTION IN MAXIMUM SALARY FOR CONTRIBUTION PURPOSES

The maximum income on which employees can get tax relief is being reduced from €150,000 p.a. to €115,000 p.a. The effect of this is to change the limits on employee contributions as follows:

Age	Limit on contributions as % of remuneration	2011 limit	2010 limit
Under 30	15%	€17,250	€22,500
30 – 39	20%	€23,000	€30,000
40 – 49	25%	€28,750	€37,500
50 – 54	30%	€34,500	€45,000
55 – 59	35%	€40,250	€52,500
60 or over	40%	€46,000	€60,000

The lower €115,000 p.a. cap will apply to employee contributions from 2011. Contributions for 2010 may still be paid during this December on the basis of the existing €150,000 p.a. cap. However backdated contributions paid in 2011 in respect of 2010 will be limited by the €115,000 cap, so anyone over this limit should consider paying AVCs now if they have scope to do so.

### WHAT TO DO...

Consider maximising AVCs for 2010 before the end of the year instead of waiting until next October/November, when the €115,000 salary ceiling will apply to backdated contributions. It is uncertain at this stage whether PRSI relief will be allowed next year on backdated contributions.

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## TAX-FREE LUMP SUM CAPPED AT €200,000

As widely expected, the maximum cash that can be taken from a pension scheme at retirement tax-free is being capped at €200,000. This will affect retirements occurring from 1 January 2011. The cap impacts those with income over €133,333 with sufficient service.

Retirement lump sums in excess of this amount will be taxed at the standard rate of income tax up to a further €375,000, with any balance in excess of this being taxed at the individual's marginal rate. All such lump sums taken since 7 December 2005 count towards the €200,000 limit.

There is also a lifetime limit of €200,000 on ex gratia payments on termination of employment, also with effect from 1 January 2011. Any excess will be taxed at the individual's marginal rate. The difference in tax treatment between such payments and retirement lump sums should be considered by higher earners when deciding whether to waive their right to a retirement lump sum in exchange for a higher termination payment.

### WHAT TO DO...

A person with a high salary who is eligible to retire this year might consider retiring before the end of December so as to get a tax free lump sum in excess of the new €200,000 limit. However this can be a complex process and may have implications for the overall value of the individual's retirement benefits and their ability to continue working.

## IMPUTED WITHDRAWALS FROM ARFS INCREASED TO 5%

Any money withdrawn from an ARF is taxed at the individual's marginal rate. Up to now there has been a tax charge based on a notional drawdown of 3% of the ARF value each year.

The Minister announced that there will be income tax on an imputed drawdown of 5% of the ARF value each year. As before, any actual drawdown will be taxed as usual and will reduce this notional drawdown. The 5% imputed drawdown is an increase from the existing 3%. This new rate will apply to the value of ARF assets as at 31st December 2010 and will be payable in January / February 2011.

### WHAT TO DO...

If you are an ARF holder, consider drawing down 5% at least by the end of the year, to access funds to pay the tax and to avoid double taxation.

## STANDARD FUND THRESHOLD REDUCED TO €2.3 MILLION

The Standard Fund Threshold ("SFT") is the maximum capital value of pension allowed by the Revenue Commissioners. Any amount in excess of the SFT is subject to 41% tax on the capital amount at retirement. The net excess is then taxed in the usual manner for retirement benefits.

The SFT was introduced in 2005 at a level of €5 million and was indexed up to €5,418,085 since then. The SFT is being reduced to €2.3 million with effect from 7 December 2010.

Individuals whose fund already exceeds €2.3 million have until June 2011 to apply to Revenue for a Personal Fund Threshold ("PFT"). The PFT is the total of the individual's pre-retirement pension fund and any pension benefits taken since 7 December 2005, subject to the old cap of €5,418,085. Benefits taken before 7 December 2005 are ignored for SFT/PFT purposes.

Anyone who already had a PFT in excess of the old cap, as a result of having a pension fund worth more than €5 million in 2005, keeps their existing PFT.

The fund value in a defined contribution scheme is quite clear. In a defined benefit scheme, a multiplier of 20 is applied to the benefit to calculate whether the fund is over the SFT/PFT or not.

The new SFT does not affect existing pensioners, but it will impact individuals with a future entitlement to a defined benefit pension of over €115,000 – essentially this will restrict maximum benefits for anyone whose salary is over €172,500 and has sufficient service. Where an active member has already accrued a pension of €115,000, any further accrual of pension would be subject to 41% tax on the capital value within three months of retirement, on top of the usual tax due.

### WHAT TO DO...

Check current value of retirement fund. If over €2.3 million, apply for PFT early in new year.

If at or close to the new threshold, consider cutting back on pension contributions and/or looking at alternative ways of investing.

## **APPROVED RETIREMENT FUND EXTENDED TO ALL DEFINED CONTRIBUTION PENSIONS**

From 2011 all those with defined contribution pension arrangements will be able to opt for an Approved Retirement Fund (“ARF”) or taxed cash instead of using their pension fund to purchase an annuity.

Up to now only the self-employed and 5% directors have had these options in relation to their entire fund – other employees could place their AVCs in an ARF but not the rest of their fund.

As before, money can only be placed in an ARF or taken as taxed cash where the individual has a guaranteed minimum income. This minimum is being increased from €12,700 p.a. to approximately €18,000 p.a. (inclusive of the State pension).

If the individual cannot meet the minimum income requirement, they must place approximately €120,000 (increased from €63,500) in an Approved Minimum Retirement Fund (“AMRF”) which cannot be touched until age 75.

A new part of the ARF regime under the Budget is that if the individual satisfies the c.€18,000 p.a. minimum income requirement at any stage after retirement, the AMRF is converted to an ARF and can be drawn down before age 75. This could apply if, say, an individual retires at age 60 with an annuity of €10,000. At age 65 they become entitled to the State pension and their guaranteed income instantly exceeds €18,000. They can then get access to the moneys in the AMRF (now ARF).

The old minimum income requirement of €12,700 will continue to apply for three years following the Finance Act, 2011 in respect of those who have already retired. If their guaranteed income increases to over €12,700 at any stage in the next three years, their AMRF can become an ARF as above.

In December 2008, members of defined contribution schemes who were retiring were given the option of taking their tax-free cash but deferring purchase of an annuity until up to 31 December 2010. This deferral period is being extended so that these retirees can take advantage of the ARF options next year.

## **WHAT TO DO...**

Careful planning will be needed in advance of retirement to determine how best to use the new flexibility, to investment funds appropriately having regard to post retirement needs and how to secure the necessary income or AMRF required to take advantage of the new rules.

## **SOVEREIGN ANNUITIES AN AID TO DEFINED BENEFIT SOLVENCY?**

It is a well known fact that the majority of Defined Benefit (DB) Schemes in Ireland do not meet the Minimum Funding Standard under the Pensions Act and are therefore technically insolvent.

A key factor in this situation is the cost of pensions, which has to be calculated as the cost of buying annuities for retired members on the open market. These annuities are priced using the yields under French and German Government bonds, which are very low, resulting in high pension costs.

The proposal is to allow funds to calculate the cost of pensions by reference to the yield on Irish bonds, which tend to be higher than their French or German counterparts. This would reduce the cost of securing pensions and should reduce the liabilities of a DB scheme.

To make this happen, the National Treasury Management Agency will issue suitable bonds for the purpose. Schemes that invest in these bonds will be able to value pensioner liability by reference to these yields. As an alternative, trustees may discharge their obligations to pensioners by buying annuities based on the new bonds on their behalf, in which case the pensioner will bear the default risk.

The Minister for Social Protection stated on Budget Day that “there is absolutely no risk of Ireland defaulting on its sovereign debt... it simply will not happen.” Whether the investment markets are equally convinced remains to be seen. It is planned that bonds and sovereign annuities will be available in January 2011, with yields based on market conditions then. At the same time details of a proposed new defined benefit model and related changes to the funding standard will be released. The new deadline for underfunded schemes to submit funding proposals to the Pensions Board will also be unveiled then.

## STATE PENSION LEFT UNTOUCHED

The State Pension (Contributory) and State Pension (Transition) will remain at their existing rate of €230.30 per week, or €11,975.60 p.a. This is good news for defined benefit schemes which are integrated with the State pension – any cut would have increased the occupational scheme's liabilities.

Public sector pensioners will face a cut of, on average, 4% in their pensions. Private sector pensions are protected by the Pensions Act, 1990 from being cut in a similar manner.

Public Sector Pension	% reduction
First €12,000	0%
€12,001 to €24,000	6%
€24,000 to €60,000	9%
Over €60,000	12%

## UNIVERSAL SOCIAL CHARGE REPLACES HEALTH AND INCOME LEVIES

The health levy and income levy will be replaced in 2011 by a new Universal Social Charge of up to 7% of income.

Income p.a.	Universal Social Charge
Total income below €4,004	0%
Income up to €10,036	2%
Income between €10,037 and €16,016	4%
Income over €16,016	7%

The Minister has been accused of targeting lower earners while protecting the higher paid. Certainly this is one instance where it appears to have that impact.

Under the existing regime, Barry, who earns €25,000 p.a. currently pays no health levy, and an income levy of €500. In 2011 he will pay a Universal Social Charge of €1,068.76 – more than doubling his obligation.

Meanwhile Sandra earns €250,000 p.a. (ten times Barry's salary) and pays combined income levy and health levy of €21,749.28. She will only pay a Universal Social Charge of €16,818.76 – nearly €5,000 less in 2011 than in 2010.

On the flip side, the employee PRSI ceiling of €75,036 will be removed. This means Sandra will have to pay an additional €6,998.56 in PRSI.

## BUDGET IMPACTS EMPLOYEE SHARE SCHEMES

There will be a charge to PRSI and the Universal Social Charge on Approved Profit Sharing Schemes and approved Save As You Earn Schemes. In addition, the following reliefs have been abolished: Approved Share Option Schemes (effective from 24 November 2010), new shares purchased by employees, and childcare provided on the employer's premises.

## OTHER FEATURES INCLUDE:

- The scrapping of the earnings limit on employer PRSI. Employers will now pay PRSI (currently 10.75%) on the entire salary, not just income up to €75,036.
- The Capital Acquisitions Tax thresholds are being reduced by 20%. This may impact the level of tax payable on death in service lump sum benefits.

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